INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	1
Treaty and statute involved	2
Statement	2
Argument	6
Conclusion	13
Appendix A	14
Appendix B	17

CITATIONS

Cases:

Abbot Laboratories International Co. v. *United States*, 160 F. Supp. 321, affirmed *per curiam*, 267 F. 2d 940 — 9

American Chicle Co. v. *United States*, 316 U.S. 450 — 4, 5, 6, 7, 9, 10

Biddle v. *Commissioner*, 302 U.S. 573 — 7

Burnet v. *Chicago Portrait Co.*, 285 U.S. 1 — 7

Treaties and Statutes:

Fourth Supplementary Protocol of March 17, 1966, 17 U.S. Treaties 1254, 1261–1262, Art. 9 — 13

Income Tax Convention between the United States and the United Kingdom, April 16, 1945, 60 Stat. 1377, as amended:

Art. I — 2, 14

Art. XIII — 2, 4, 5, 6, 7, 8, 11, 12, 13, 14

Internal Revenue Code of 1939, Sec. 131(a) (26 U.S.C. (1952 ed.) 131(a)) — 7

336-008—69——1

Treaties and Statutes—Continued
Internal Revenue Code of 1954: Page
Sec. 243 8
Sec. 245 8
Secs. 901–906 7
Sec. 901 10
Sec. 901(a) 2, 15
Sec. 901(b) 2, 7, 8, 12, 15
Sec. 902 4, 5, 6, 8, 9, 10, 12, 13
Sec. 902(a) 2, 16
Sec. 902(c) 2, 16
Sec. 904 10, 11
Sec. 904(a) 2, 16
Revenue Act of 1928, Sec. 131(a), 45 Stat. 829 7
Miscellaneous:
Alexander, *The Income Tax Convention with the United Kingdom,* 2 Tax L. Rev. 295 (1947) 12
Gordon, *Effect of Recent Treaty Changes on U.S. Taxation of Business Abroad,* 26 J. of Taxation 218 (1967) 13
Owens, *The Foreign Tax Credit* (1961) 6, 7
S. Exec. Rep. No. 4, 79th Cong., 2d Sess. (2 Leg. Hist. of Tax Conv. 2721) 12
S. Exec. Rep. No. 6, 79th Cong., 1st Sess. (2 Leg. Hist. of Tax Conv. 2651) 12
S. Exec. Rep. No. 3, 89th Cong., 2d Sess 13
Senate Hearings before a Subcommittee of the Committee on Foreign Relations on Conventions with Great Britain and Northern Ireland Respecting Income and Estate Taxes, 79th Cong., 1st Sess. (2 Leg. Hist. of Tax Conv. 2583) 12
Taxation in the United Kingdom, World Tax Series (Harv. L. School, 1957) 3

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 955

THE NATIONAL CASH REGISTER COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. 1a–10a) is reported at 400 F. 2d 820. The opinion of the district court (R. 13a–32a) is reported at 270 F. Supp. 930.

JURISDICTION

The judgment of the court of appeals was entered on September 12, 1968, and the petition for rehearing was denied on October 23, 1968. (Pet. 11a.) The petition for a writ of certiorari was filed on January 18, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a credit for the United Kingdom standard (income) Tax paid by petitioner's British subsidiaries

may be claimed under both Article XIII of the Income Tax Convention with the United Kingdom and Section 902 of the Internal Revenue Code of 1954.

TREATY AND STATUTE INVOLVED

The pertinent parts of Articles I and XIII of the Income Tax Convention of April 16, 1945, between the United States and the United Kingdom, 60 Stat. 1377 (as amended by the Third Supplementary Protocol of August 19, 1957, 9 U.S. Treaties 1329, Art. II), and of Sections 901(a) and (b)(1), 902(a) and (c)(1), and 904(a) of the Internal Revenue Code of 1954 are set forth in Appendix A, *infra*.

STATEMENT

1. During 1958, the taxable year in question, petitioner, an American corporation, owned all of the voting stock of two subsidiary corporations, The National Cash Register Co., Ltd. and the National Cash Register (Manufacturing) Ltd. Both of these subsidiaries were organized under the laws of the United Kingdom. (Pet. 1a.)

As British corporations, both of petitioner's subsidiary corporations were subject to the then applicable United Kingdom standard tax on income imposed at the flat rate of 38.75 per cent on corporations and individuals, and a profits tax, applicable only to corporations, at the rate of 10 percent. Both the standard tax and the profits tax were imposed on a resident corporation's net earnings for the taxable year, without deduction for any dividends declared

from such earnings; neither tax was deductible in computing the other. (Pet. 3a; R. 16a.) [1]

In 1958, petitioner received $2,591,171 in dividends "free of standard tax" and $1,693,857 in other income from its two wholly owned British subsidiaries. In that year, these subsidiaries paid $2,667,233 in standard tax and $542,976 in profits tax to the United Kingdom. (R. 14a–15a, 18a.)

During the year in question, a corporation residing in the United Kingdom could declare dividends either "free of standard tax" or "with deduction of standard tax." When dividends were paid "free of standard tax," as they were here, the declared amount of the dividend is actually paid to the shareholder and the dividend is not subject to any additional United Kingdom standard tax after it has been paid to the shareholder. For British tax purposes other than the assessment of standard tax, the shareholder is required to include the so-called "grossed-up" dividend in income.[2] This is the amount of the dividend actually received, plus the amount of the standard tax rate effective at the time of distribution. (R. 16a–17a, 18a.) [3]

2. In its United States 1958 tax returns petitioner chose to compute a foreign tax credit for the stand-

[1] "R." references are to the separately bound Appendix C to the petition.

[2] A detailed explanation of the United Kingdom Tax treatment of dividends appears in *Taxation in the United Kingdom*, World Tax Series (Harv. L. School, 1957) pp. 255–258.

[3] As the Sixth Circuit noted (Pet. 4a, n.6):

> If a British corporation declared a dividend of $6.00 "free of standard tax" and if the standard tax were im-

ard tax paid by its subsidiaries under Article XIII of the Income Tax Convention between the United States and the United Kingdom. It included in its taxable United States income $4,230,483.68, which represented the dividend declared and received in the amount of $2,591,171.26 plus the standard tax "appropriate to" the dividend in the amount of $1,639,-312.42. In addition to the $1,639,312.42 foreign tax credit claimed under the treaty, petitioner claimed a further credit under Section 902 of the 1954 Internal Revenue Code in the amount of $1,035,313.09, which consisted of $362,497.67 for the profits tax, $3,508.85 for the miscellaneous foreign taxes, and $669,306.57 for a portion of the remaining standard tax paid by their subsidiaries.[4] (R. 22a–24a.)

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posed at the rate of 40 per cent, the shareholder would have to report $10.00, representing $6.00 for the dividend received and $4.00 for the standard tax appropriate to the dividend.

This example does not take into account the 10% profits tax. If a corporation had a profit of $10, the accumulated (after-tax) profits would be $5. If the entire $5 were distributed as a dividend, the standard tax appropriate to the dividend would be $3.33. The British shareholder never takes into income the $0.67 in standard tax appropriate to the $1 profits tax. For the purposes of this case $5,081 in other foreign income taxes may be treated in the same way as the profits tax. (R. 15a; Pet. 5, n.2; 6a, n.8.)

[4] Taxpayer made an alternative claim for a portion of the remaining standard tax in the amount of $444,746.80. (R. 24a.) To arrive at these figures, computations under the *American Chicle* formula (see footnote 7, *infra*) for the profits tax and the miscellaneous foreign taxes were made separately for each of petitioner's subsidiaries. The resulting amounts for the credits for the profits tax and miscellaneous taxes were added together and then subtracted from the total indirect credit claimed by petitioner for its subsidiaries to obtain the amount claimed

The Commissioner of Internal Revenue disallowed the claimed credits on the ground that credit for the standard tax may be taken either under Article XIII or under Section 902, but not under both. The Service recomputed the credits using two alternative methods: first, using Article XIII for the standard tax and Section 902 for the other taxes; and second, using Section 902 for all taxes. Under the first method, the amount of the credit allowed was $2,005,318.94,[5] with a resulting United States tax liability of $194,532.55.[6] Under the second method used, the credit as computed under the *American Chicle* formula[7] was $1,313,-539.40, which included $1,089,357.57 for the standard tax, $222,032.66 for the profits tax, and $2,149.17 for the miscellaneous foreign taxes. (R. 25a–26a.) The resulting United States tax liability on the dividends

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for the portion of the remaining standard tax. Petitioner's formulas for arriving at the total credit claimed under Section 902 are set forth at R. 23a, 24a. In making the computations throughout this brief it is necessary to treat each of petitioner's subsidiaries separately before the total amounts can be determined.

[5] The sum was derived by subtracting the portion of the remaining standard tax claimed by petitioner from its total credit.

[6] To reach this amount, subtract the foreign tax credit from the United States income tax before foreign tax credit under taxpayer's original computation. See Appendix B, *infra*.

[7] *American Chicle Co.* v. *United States*, 316 U.S. 450:

$$\frac{\text{Dividend received by petitioner}}{\text{subsidiary's "Accumulated profits"}} \times \frac{\text{subsidiary's "Accumulated profits"}}{\text{subsidiary's "Total profits"}} \times \text{Total foreign creditable taxes paid by subsidiary} = \text{Credit}$$

received from its British subsidiaries was $33,869.65.[8] (The computations are set forth in detail in Appendix B, p. 17, *infra*). A deficiency was asserted on the basis of the latter computation, since it yielded the smaller tax liability (R. 13a–14a, 25a–26a, 34a).

Petitioner paid the deficiency and instituted this action upon the denial of its refund claim. (R. 13a–14a.) The district court sustained petitioner's computation. (Pet. 7a; R. 28a–32a.) Upon appeal by the government, the court of appeals reversed, holding that petitioner must compute its credit for standard tax under either Article XIII or Section 902, but not under both.

ARGUMENT

The decision below is correct. There is no conflict among the circuits or any other basis for further review.

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[8] In this case there are two reasons why it is advantageous for the petitioner to compute its foreign tax credit under Section 902. First: unlike the direct credit situation (*e.g.*, under Article XIII of the Treaty) where the total income before foreign tax is included in gross income for United States tax purposes and a credit is allowed equal to the amount of the foreign tax paid on the amount included in gross income at the statutory foreign tax rate, under Section 902 only foreign income after foreign tax is included in United States gross income and a credit is allowed for the foreign tax paid on the accumulated profits distributed as dividends. Thus, both a deduction and a credit is afforded for foreign taxes. The result is an aggregate tax rate that may be less than the 52 percent United States tax rate. Second, when "total profits" as used in the *American Chicle* formula do not equal the British taxable income on which the standard tax is imposed, the effective standard tax rate may be greater (as is the case here) under Section 902 than the statutory foreign standard tax rate. See Owens, *The Foreign Tax Credit* (1961) pp. 113–118, 125–126.

1. In order to eliminate double taxation by assuring as nearly as possible that income subject to tax in both the United States and a foreign country is taxed at no more than the higher of either the United States or foreign rate,[9] Sections 901–906 of the Internal Revenue Code of 1954 allow American taxpayers to claim credit for foreign taxes if specified conditions are met. The basic provision applicable here is Section 901(b)(1), which provides that "a domestic corporation" may have a credit, subject to limits established in Section 904, for "the amount of any income, war profits, and excess profit taxes paid or accrued during the taxable year to any foreign country * * *." This provision, however, speaks only in terms of taxes the American taxpayer has paid directly to foreign governments. Thus, in *Biddle* v. *Commissioner,* 302 U.S. 573, this Court, in interpreting the predecessor provision to Section 901(b)(1),[10] held that an American shareholder of a British corporation could not claim a credit for the British standard tax paid by the corporation, even though the shareholder's "grossed-up" dividend included a ratable portion of the standard tax paid by the corporation.

This rule was modified, however, by Article XIII of the Income Tax Convention of April 16, 1945, between the United States and the United Kingdom, 60 Stat. 1377. Section (1)(a) of that Article pro-

[9] *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1, 8; *American Chicle* v. *United States*, 316 U.S. 450, 451; Owens, *The Foreign Tax Credit* (1961), pp. 3, 113, 295–296.

[10] Section 131(a) of the Revenue Act of 1928; see, also, Section 131(a) of the Internal Revenue Code of 1939.

vides that "the recipient of a dividend paid by a corporation which is a resident of the United Kingdom shall be deemed to have paid the United Kingdom tax appropriate to such dividend * * *." As a result, an American shareholder of a British corporation is allowed to claim a credit under Section 901(b)(1) of the 1954 Code to the same extent as he could if he had paid the standard tax "appropriate to" his dividend directly to the British government.

A different type of foreign tax credit is generally allowed by Section 902. This provision is an analogue to the dividend received deduction that Sections 243 and 245 of the 1954 Code allow a domestic corporation. Section 902 applies only to domestic corporations which own at least 10 per cent of the voting stock of a foreign corporation. Once that minimum shareholding percentage is met, the American corporation is "deemed" to be the payor of the fraction of the foreign taxes that the subsidiary paid "on or with respect to [the] * * * accumulated profits" from which the dividends were paid.

It is readily apparent that Article XIII and Section 902 each provide relief in the same general set of circumstances—the payment of a dividend by a British corporation to an American shareholder. Section 902 applies only when the shareholder is an American corporation owning at least 10 per cent of the voting stock in the British corporation, while Article XIII is available to any American national regardless of the extent of his stockholdings. In each situation the respective provision holds that the American tax-

payer is "deemed" to have paid the foreign tax that was in fact paid by the British corporation.

If the conditions of Section 902 are met, there is an obvious overlap between it and Article XIII of the Convention. Each provision applies only when in fact a dividend has been paid to the American shareholder. *Abbot Laboratories International Co.* v. *United States,* 160 F. Supp. 321, 328 (N.D. Ill.), affirmed *per curiam,* 267 F. 2d 940 (C.A. 7); see, also, *American Chicle Co.* v. *United States,* 316 U.S. 450, 452. In either case, the credit is limited to the ratable portion of the British tax attributable to the dividend received by the American shareholder.

Petitioner seeks to take advantage of the overlap between these provisions by claiming both a credit under the treaty for the British standard tax appropriate to the dividends received by it and reported in its United States taxable income and a credit under Section 902 for a portion of the remaining standard tax paid by its subsidiaries in the amount of $669,306.57 (or under its alternative claim of $444,746.90). (R. 23a, 24a.) The treaty, however, allows petitioner credit for the full amount of the standard tax attributable to the distributed part of the subsidiaries' profits. The remaining amount of the standard tax—*i.e.,* the amount for which petitioner claims credit under Section 902—is attributable to monies that were not distributed as dividends but were instead retained as undistributed accumulated profits[**] or used to pay

[**] Petitioner's subsidiaries distributed only 5% of their accumulated profits (R. 15a, 18a).

the British profits tax.[12] Thus petitioner seeks to misuse Section 902 by obtaining a credit for British taxes attributable to amounts not paid to it as a dividend, contrary to the express language of Section 902.

2. Petitioner's case is not advanced, as it suggests, by the fact that Section 904 is no bar to the credit claimed (Pet. 5, 18; R. 27a). That provision limits the amount of the foreign tax credit allowable under the direct and indirect credits to "the same proportion of the tax against which such credit is taken [*i.e.*, before-credit United States tax] which the taxpayer's taxable income from sources within such country * * * bears to his entire taxable income." Thus, the credit may in no event exceed the pre-credit United States tax on the foreign income.

The Section 904 limitation thus establishes a maximum credit that may be claimed, but offers no additional credit when the credit allowable under Sections 901 and 902 is less than the maximum. In addition, the only reason petitioner's computation suggests compliance with Section 904 is because it assumes that the limitation is based on the pre-credit United States tax due on petitioner's total United Kingdom income, which includes not only the dividends but $1,693,857 in other income (Pet. 7a). If the other income is eliminated, then the maximum credit allowable under

[12] No credit is available for the amount of standard tax appropriate to the amounts used to pay British profits tax. See *American Chicle*, *supra*, 316 U.S. at 452. Here, the subsidiaries used more than $540,000 (R. 15a) of their pre-tax earnings, which were subject to standard tax, to pay the profits tax, which was not deductible for the purposes of the standard tax (R. 15a, 16a).

Section 904—the pre-credit United States tax on the dividends—would be $2,199,851, considerably less than the credit of $2,674,625 which petitioner claims. See Appendix B, *infra,* lines (d) and (f). On the other hand, the credit of $1,313,539 approved by the Sixth Circuit would be slightly less than the before-credit tax liability of $1,347,409,[13] producing a federal tax liability on the dividends of $33,869. Appendix B, p. 17, *infra,* lines (d), (g), and (h). This result—and not petitioner's—comports with the foreign tax credit's purpose of insuring that foreign profits are taxed at the higher of the foreign rate or the United States rate. Since the aggregate British tax rate, approximately 50%,[14] is less than the United States rate for 1958 of 52%, a small federal tax should be due on the dividends. The real effect of petitioner's computation is to generate excess tax credits large enough to eliminate any federal tax on the dividends and to reduce significantly the federal tax due on the other income. Appendix B, *infra,* lines (j) and (k).

3. The decision of the court of appeals is neither inconsistent with *Biddle* nor does it deny petitioner any benefit accorded by the treaty. (See Pet. 7, 15–16, 19–20.) The purpose of Article XIII, which was part

[13] The difference between the before-credit tax liabilities computed under petitioner's theory and under the court of appeals' holding is due to petitioner's inclusion in income of the standard tax appropriate to the dividends. Appendix B, *infra*, line (b), p. 17.

[14] The United Kingdom standard tax is 38.75% and the profits tax 10% and since neither is deductible in computing the other, the aggregate rate is approximately 50%. We include in this figure the miscellaneous foreign income taxes. (R. 15a, 16a.)

of the settlement of the broader problem of the taxation of dividend income by both signatories, was to afford relief from the principle of the *Biddle* case, and it enables shareholders not qualifying for the indirect credit of Section 902 to take a credit for standard tax under Section 901(b).[16] But Article XIII expressly states that it is "Subject to Sections 901 to 905 of the United States Internal Revenue Code". There is no basis in the treaty or in *Biddle* for applying Section 902 to any amount of British standard tax except that allocable to the dividends in fact paid to petitioner. Since that amount of standard tax is covered by the treaty, the case must yield to the rule that requires a taxpayer to choose among duplicative tax benefits, and the Sixth Circuit's decision to this effect contains no infringement of Article XIII.

The treaty does no more than grant corporate shareholders relief as an alternative to a credit under Section 902.[17] While Section 902 ordinarily provides a greater tax benefit than does Article XIII, there are circumstances in which the reverse is true.[18] Consequently, by allowing corporate 10 per cent sharehold-

[15] [16] Senate Hearing before a Subcommittee of the Committee on Foreign Relations on Conventions with Great Britain and Northern Ireland Respecting Income and Estate Taxes, 79th Cong., 1st Sess., pp. 60, 70–71, 77 (2 Leg. Hist. of Tax Conv. 2583, 2626, 2636–2637, 2643); S. Exec. Rep. No. 4, 79th Cong., 2d Sess., p. 18 (2 Leg. Hist. of Tax Conv. 2721, 2738); Alexander, *The Income Tax Convention with the United Kingdom*, 2 Tax L. Rev. 295, 322–325 (1947).

[16] [17] See Technical Memorandum of the Treasury Department on the Convention (S. Exec. Rep. No. 6, 79th Cong., 1st Sess., pp. 5, 11).

[17] [18] Owens, *The Foreign Tax Credit* (1961), pp. 370–372.

ers a choice between Section 902 and Article XIII, the negotiators insured that such shareholders would not lose the benefits previously accorded them and yet would have at least the same relief which Article XIII provides to other shareholders.

4. The issue presented is of limited future importance. In 1965, the United Kingdom eliminated the standard tax and adopted separate corporate and individual income taxes, and Article XIII was then extensively changed.[18] The Internal Revenue Service advises that the issue is presently pending in one case in the Court of Claims and in seven cases at the administrative level, involving claims of $3,734,138 in total.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MARCH 1969.

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[18] Fourth Supplementary Protocol of March 17, 1966, 17 U.S. Treaties 1254, 1261–1262, Art. 9; Exec. Rep. No. 3, 89th Cong., 2d Sess., pp. 5, 33–34, 47–50; Gordon, *Effect of Recent Treaty Changes on U.S. Taxation of Business Abroad*, 26 J. of Taxation 218 (1967).

APPENDIX A

Income Tax Convention of April 16, 1945, between the United States and the United Kingdom, 60 Stat. 1377 (as amended by the Third Supplementary Protocol of August 19, 1957, 9 U.S. Treaties 1329, Art. II):

ARTICLE I

(1) The taxes which are the subject of the present Convention are:

(a) In the United States of America: The Federal income taxes, including surtaxes and excess profits taxes (hereinafter referred to as United States tax).

(b) In the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the excess profits tax and the national defense contribution (hereinafter referred to as United Kingdom tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequently to the date of signature of the present Convention or by the government of any territory to which the present Convention is extended under Article XXII.

* * * * *

ARTICLE XIII

(1) Subject to Sections 901 to 905 of the United States Internal Revenue Code as in effect on the 1st day of January 1956, United

Kingdom tax shall be allowed as a credit against United States tax. For this purpose

(a) the recipient of a dividend paid by a corporation which is a resident of the United Kingdom shall be deemed to have paid the United Kingdom tax appropriate to such dividend, and

(b) the recipient of any royalty or other amount coming within the scope of Article VIII of the present Convention shall be deemed to have paid any United Kingdom tax legally deducted from the royalty or other amount by the person by or through whom any payment thereof is made,

if the recipient of the dividend or royalty or other amount, as the case may be, elects to include in his gross income for the purposes of United States tax the amount of such United Kingdom income tax.

Internal Revenue Code of 1954:

SEC. 901. *Taxes of Foreign Countries and of Possessions of United States.*

(a) *Allowance of Credit.*—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902 * * *.

(b) *Amount Allowed.*—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) *Citizens and Domestic Corporations.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States;

* * * * *

[26 U.S.C. (1958 ed.) 901.]

SEC. 902. *Credit for Corporate Stockholder in Foreign Corporation.*

(a) *Treatment of Taxes Paid by Foreign Corporation.*—For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits.

* * * * *

(c) *Applicable Rules.*—

(1) The term "accumulated profits," when used in this section in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war profits, and excess profits taxes imposed on or with respect to such profits or income * * *.

* * * * *

[26 U.S.C. (1958 ed.) 902.]

SEC. 904. *Limitation on Credit.*

(a) *Limitation.*—The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

[26 U.S.C. (1958 ed.) 904.]

APPENDIX B

The differences between the taxpayer's original computation of its foreign tax credit for 1958, its alternative computation, and the computation made by the Internal Revenue Service are shown by the following table:

	Taxpayer's Original Computation (R. 22a-23a)	Taxpayer's Alternative Computation (R. 23a-24a)	Internal Revenue Service's Computation (R. 25a-26a)
Taxpayer's U.S. taxable income from its U.K. subsidiaries also subject to creditable foreign taxes:			
(a) Dividends (R. 18a)	$2,591,171.26	$2,591,171.26	$2,591,171.26
(b) Standard tax "appropriate to" dividends (R. 18a)	$1,639,312.42	$1,639,312.42	
(c) Total	$4,230,483.68	$4,230,483.68	$2,591,171.26
U.S. income tax, before foreign tax credit, on income also subject to creditable foreign taxes:			
(d) 52% of line (c)	$2,199,851.51	$2,199,851.51	$1,347,409.05
Taxpayer's foreign tax credit under Sec. 901 (without regard for limitation under Sec. 904):			
(e) Computed under Sec. 901(b) and the Convention (R. 22a-24a)	$1,639,312.42	$1,639,312.42	
(f) Computed under Sec. 902(a) (R. 22a-26a)	$1,035,313.09	$ 810,753.42	$1,313,539.40
(g) Total	$2,674,625.51	$2,450,065.84	$1,313,539.40
U.S. income tax, after foreign tax credit, on income also subject to creditable foreign taxes:			
(h) line (d) minus line (g)	($ 474,774.00)	($ 250,214.33)	$ 33,869.65
(i) (R. 18a)	$1,693,857.13	$1,693,857.13	$1,693,857.13
U.S. income tax on income not also subject to creditable foreign taxes:			
(j) 52% of line (i)	$ 880,805.70	$ 880,805.70	$ 880,805.70
U.S. income tax, after foreign tax credit, on taxpayer's total income from its U. K. subsidiaries:			
(k) line (h) minus line (j)	$ 406,031.70	$ 630,591.37	$ 914,675.35

The amount of income taxes involved in this case is the difference between the taxpayer's liability (line k) as computed by the Internal Revenue Service ($914,675.35) and as computed by the taxpayer under its original computation ($406,031.70) and its alternative computation ($630,591.37).

U.S. GOVERNMENT PRINTING OFFICE: 1969